

Constraints to India's Support for Regional Economic Integration

By Surupa Gupta

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In February 2018, India regained its position as the fastest growing large economy in the world, growing at more than seven percent for three preceding quarters and surpassing China. However, despite support for sub-regional integration in the Bay of Bengal region, the prospect that India will lead the charge on regional integration or even play a central role in efforts in Asia overall, remains dim. Several constraining factors, many of which have to do with India's domestic political economy, make such a leadership role unlikely. Pushback from interest groups, India's federal structure, and the ruling party's nationalist rhetoric are among several factors that shape India's approach to economic liberalization in general and regional integration in particular.

India has several reasons to advocate for regional integration. In 2014, the Modi government came to power promising economic development for all. Once in office, Modi's flagship initiative was “Make in India” – an effort to make India a manufacturing hub. Two factors drove this effort: The need to create jobs for the millions of young Indians coming into the workforce and the need to generate a high rate of GDP growth that can help achieve other developmental goals. There is evidence that the swing towards BJP in 2014 was, in part, due to mobilization of new, young voters attracted to Modi's message of “inclusive development for all.”

Given that message, regional integration should have been an important part of foreign policy: It acts as a channel for foreign investment and trade, particularly in today's economy where manufacturing is reliant on integrated cross-border value chains. It is difficult to deliver high GDP growth without simultaneous growth in trade. Given that India sits in South Asia, one of the least integrated regions in the world, it would not have been unreasonable to expect India to lead the charge on regional integration both within the region and between South Asia and its neighbors.

In reality, India's record on this count is mixed. While Modi has repeatedly spoken against rising protectionism at international venues, his domestic messaging and actions have been far more nationalist. Modi began with a “neighborhood first” focus in foreign policy but the focus soon shifted to the east. India subsequently showed initiative in pushing for a smaller sub-regional integration effort called the Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation (BIMSTEC). At the same time, it has been a reluctant player in the megaregional integration effort, the Regional Comprehensive Economic Partnership (RCEP). Explaining this divergence provides some clues about the domestic political and economic forces that shape India's efforts in this issue area.

Broad-based opposition to RCEP has come from India's business sector which assesses it would open up the Indian economy to further competition from Chinese manufacturers. Business chambers such as the FICCI and CII have mostly opposed RCEP. The national government is concerned further Chinese competition will increase the roughly \$40 billion trade deficit. India's service industry, which is more outward-oriented, sees little opportunity to advocate for RCEP, given opposition to service sector opening among some trade partners. Indian businesses largely argue that they face higher costs of production on account of inadequate and expensive utility and infrastructure and due to lack of structural reforms in land, labor and banking. While some of their criticism is on point, it is also true that India's large business houses have been beneficiaries of existing policies and many of them have an interest in keeping a growing market protected. It is important to point out that in case of BIMSTEC, instead of threats, Indian businesses see opportunity.

Moreover, Indian politicians have resisted trade liberalization in the farm sector in the name of the small farmer. While it is true that in the context of India's highly fragmented small-farms economy, destabilizing price fluctuations will likely have grave economic and political impact, the political leadership has not been able to deliver either higher incomes to these farmers or alternative jobs to them and their children. The policy status quo benefits large farmers and plantations, who are politically well-represented through state politicians. Increasingly, despite their lack of organization, India's small farmers have attracted attention through protests and suicides in several states.

The Indian economy is going through a structural change. The proportion of GDP from agriculture has been on the decline for decades; more recently, the proportion of workforce dependent on agriculture, though still high, has also been declining rapidly. At the same time, manufacturing growth has been anemic. While foreign investment flows have improved, little of that has gone in creating manufacturing or low-skilled service sector jobs that can absorb the labor released by the farm sector. The government has taken few measures, with the exception of tax reform, to remove the bottlenecks that limit India's potential for growth and job creation in manufacturing. "Make in India" and subsequent policy documents have demonstrated strong nationalist rhetoric that resonate with the supporters of the ruling party. Several groups, such as the RSS and the Swadeshi Jagaran Manch, that provide electoral and other support to the ruling party are strongly protectionist themselves.

The above account paints a dismal picture regarding the prospect for regional integration. Regional integration has a security and political component that might both drive and impede economic reforms. The choice of BIMSTEC likely reflects India's pessimism about regional integration efforts involving Pakistan. At the same time, China's Belt and Road Initiative has certainly pushed India towards sub-regional cooperation efforts. Parliamentary elections at the federal level are due within a year. Even though the imperative of inclusive economic development and job creation suggests that the government should embrace reforms, the lack of a strong liberalizing coalition would lead to the conclusion that such prospects are not looking bright in the immediate future. While India will likely continue to push for greater connectivity within BIMSTEC, it is less likely to emerge as an advocate for larger integration in Asia in the near term.

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